

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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|   |   |                |
|---|---|----------------|
| In the Matter of the Petition                 | : |                |
| of  | : |                |
| STEPHEN AND REBECCA GREENWALD                 | : | DETERMINATION  |
|   | : | DTA NO. 806467 |
| for Redetermination of a Deficiency or for    | : |                |
| Refund of New York State and New York City    | : |                |
| Personal Income Taxes under Article 22 of the | : |                |
| Tax Law and Chapter 46, Title T of the        | : |                |
| Administrative Code of the City of New York   | : |                |
| for the years 1982 and 1983.                  | : |                |

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Petitioners, Stephen and Rebecca Greenwald, c/o Michael Dinkes, C.P.A., 11 Sunrise Plaza, Valley Stream, New York 11582, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York for the years 1982 and 1983.

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on June 19, 1991 at 10:15 A.M., with all briefs to be filed by January 24, 1992. Petitioners appeared by Israeloff, Trattner & Co. (Michael Dinkes, C.P.A.). The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUE

Whether petitioners substantiated a partnership loss claimed on their 1983 tax return, part of which was deducted against income for said year, and part of which was carried back to 1982.

FINDINGS OF FACT

Petitioners, Stephen and Rebecca Greenwald, filed a Federal income tax return for 1983 showing, on Schedule E, partnership income of \$269,554.00 and partnership losses of \$920,841.00, for a net loss of \$651,287.00. The partnership losses included losses of

\$763,836.00 and \$2,563.00 claimed with respect to Active, Ltd.

Petitioners filed a New York State and City of New York Resident Income Tax Return for 1983 based on Federal income which included the net partnership loss of \$651,287.00.

Petitioners subsequently filed a Form 1040-X, Amended U.S. Individual Income Tax Return, for 1982, claiming a net operating loss carryback of \$236,382.00 from 1983.

Petitioners also filed a New York State and City of New York claim for credit or refund of personal income tax, claiming a refund of \$35,000.00 for 1982, based on the carryback loss of \$236,382.00 and an alimony deduction of \$21,850.00 omitted from the original return.

The matter was assigned to an auditor on November 15, 1985. The case initially involved another partnership in which petitioner Stephen Greenwald was a partner, but any issue with respect to said partnership has apparently been resolved. On March 17, 1986, the auditor received the entire file on the net operating loss carryback from 1983 and petitioners' claim for refund.

On October 1, 1986, the auditor called petitioners' accountant and asked him to substantiate the partnership losses, the three Schedule C's filed by petitioners for 1983 and the alimony payments.

The auditor's log for December 23, 1986, states that the auditor "verified the computer for Active, Ltd. partnership loss", apparently confirming that the partnership had reported such loss. The auditor learned that petitioner Stephen Greenwald had filed a partnership return for an entity called Weber Associates with the same identification number as Active, Ltd. Petitioners' representative told the auditor that petitioners had moved to California and that he would contact petitioners and substantiate the partnership losses.

The auditor called the representative on April 7, 1987, June 12, 1987 and July 21, 1987, requesting documentation and on July 28, 1987 wrote a letter explaining what was needed for the audit. The auditor called the representative again on August 26, 1987 and the representative expressed surprise that the auditor had not received the information requested.

On September 8, 1987, the auditor received a letter from the representative stating that

petitioners' 1983, 1984 and 1985 Federal income tax returns were being audited by the Internal Revenue Service.

The auditor concluded that petitioners had not substantiated the Active, Ltd. partnership loss and the alimony deduction and recommended that the refund request be denied and a notice of deficiency be issued.

On September 30, 1987, the Division of Taxation issued a Statement of Audit Changes to petitioners, denying the refund requested for 1982 and asserting \$18,084.08 in New York State and New York City personal income tax due for 1983.

Petitioners executed two consents extending the period of limitation upon assessment of personal income taxes for the years 1982 and 1983 to October 17, 1988.

On November 25, 1987, the Division of Taxation issued a Notice of Deficiency to petitioners for \$18,084.08 in tax, \$904.20 in penalty and \$6,586.33 in interest, for a total due of \$25,574.61 for the year 1983.

A Bureau of Conciliation and Mediation Services conference was held on August 4, 1988. Petitioners' representative produced documentation to substantiate the \$21,850.00 alimony deduction and on August 22, 1988 the auditor recomputed the Statement of Audit Changes allowing a credit of \$3,171.53 for 1982 to be offset against the deficiency for 1983, resulting in a reduction in tax due to \$14,912.55, plus penalty and interest. A Conciliation Order reducing the deficiency to said amount was issued by the conferee on October 7, 1988.

Also on October 7, 1988 a letter was issued to petitioners by the Division of Taxation's Audit Group 3 in Albany stating, in pertinent part, as follows:

"Our records indicate the entire \$35,522.45 refund on your 1982 amended return was disallowed, therefore based on the above the assessments are considered correct.

If you now agree, please pay the total amount due shown at the bottom of this letter. Your payment if received within 15 days, will close this matter."

The amounts shown due on the letter for the year 1982 were as follows:

|          |                   |
|----------|-------------------|
| Tax      | 0                 |
| Interest | \$ 805.74         |
| Penalty  | <u>\$2,393.85</u> |

|       |            |
|-------|------------|
| Total | \$3,199.59 |
|-------|------------|

It is unclear how Audit Group 3 arrived at this computation. No Notice of Deficiency was issued for 1982 and, as noted above, petitioners received a credit for the alimony deduction which was allowed for 1982.

Petitioners filed a timely petition dated January 4, 1989 protesting the deficiency, which had been reduced to \$14,912.55, and also protesting the denial of refund<sup>1</sup>. The petition stated, in pertinent part:

"Active limited's [sic] sole activity is an interest in SAGE ASSOCIATES. SAGE ASSOCIATES is currently under examination by the Internal Revenue Service. No determination has been made by the internal revenue service [sic] as of the date of this petition. The commissioner DID NOT examine SAGE ASSOCIATES or active limited [sic]."

Petitioner Stephen Greenwald, a lawyer, did not practice law during 1983. He was involved in a number of different ventures, most of which were related to the motion picture industry. The ventures included acquiring and developing motion picture projects.

Active, Ltd.

Active, Ltd. is a general partnership formed on November 11, 1981 by petitioner Stephen Greenwald and his father, Samuel Wenegrat. The partnership was created so that Mr. Greenwald and his father could participate in business activities together. The offices of the partnership were apparently located in New York City during the years at issue. Under the partnership agreement, each of the partners was to contribute 50% of the capital. Profit and loss, which were to be computed at the end of each calendar year, were to be allocated equally

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<sup>1</sup>Petitioners also challenged adjustments to their medical expense deduction and the imposition of penalty and interest, on the basis that such adjustments, penalty and interest were due to the increased income resulting from the disallowance and were thus incorrect; there is no separate issue herein with respect to same.

between the partners.<sup>2</sup>

The partnership agreement was amended as of May 23, 1983 to allow for unequal contributions of capital. Paragraph 4(b) of the agreement, relating to allocation, was modified to read as follows:

"(b) Allocation of Profits and Losses: The profits and losses of the Partnership shall be allocated equally among the Partners, provided, however, that in the event the Partners have made an unequal contribution to the capital of the Partnership, as is set forth on Exhibit 'A' to this Agreement, from time to time, the profits and losses of the Partnership, with respect to the investments made with the capital contributed unequally by the Partners, shall be allocated among the Partners in the same percentage that each Partner's unequal contribution bears to the total contribution made with respect to each such investment. It is, therefore, the understanding and agreement of the Partners that with respect to certain investments of the Partnership, that the profits and losses of the Partnership shall be allocated equally among the Partners and with respect to other investments of the Partnership, that the profits and losses shall be allocated on an unequal basis, all as is set forth on Exhibit 'A', attached hereto."

Exhibit "A" attached to the agreement provided as follows:

"Exhibit 'A'"

| DATE OF<br>CONTRI-<br>BUTION <sup>3</sup> | INVESTMENT   | PARTNERS<br>PERCENTAGE<br>OF CONTRIBU-<br>TION | PARTNERS<br>ALLOCATION<br>OF PROFIT<br>& LOSS |
|---|--|--|---|
|   | Sage Associates, a<br>New York Limited Partner-<br>ship, 1.25 Units    | Greenwald: 75%<br>Wenegrat: 25%                | Greenwald: 75%<br>Wenegrat: 25%               |
|   | Sage Assocaites [sic], a<br>New York Limited Partnership,<br>.25 Units | Greenwald: 75%<br>Wenegrat: 25%                | Greenwald: 75%<br>Wenegrat: 25%               |
|   | Acquisition of an Option in<br>a Screen Play entitled 'Aura'           | Greenwald: 50%<br>Wenegrat: 50%                | Greenwald: 50%<br>Wenegrat: 50%               |

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<sup>2</sup>Petitioners' Exhibit "3".

<sup>3</sup>No date is shown on petitioners' Exhibit "4" for the first four items listed.

|         |   |                                 |                                 |
|---------|---|---------------------------------|---------------------------------|
|         | Acquisition of 50 shares of the common stock of Smith-Greenwald Properties, Inc., a New York Corporation, representing 50% of the issued and outstanding shares of said corporation | Greenwald: 50%<br>Wenegrat: 50% | Greenwald: 50%<br>Wenegrat: 50% |
| 3/31/83 | 6.25% Interest in West End Developers Associates, a New York General Partnership"   | Greenwald: 50%<br>Wenegrat: 50% | Greenwald: 50%<br>Wenegrat: 50% |

The investments contributed to Active, Ltd. listed in Exhibit "A" to the amendment of the partnership agreement dated May 23, 1983 (Finding of Fact "19") may be more particularly described as follows:

(a) Sage Associates. Sage Associates was and is a New York limited partnership in which Active, Ltd. was and is a limited partner. Sage Associates acquired for distribution a motion picture entitled "S.O.B."

(b) The option on the screenplay "Aura". Active, Ltd. owned a 50% interest in an option to purchase a screenplay entitled "Aura". The principals were unable to obtain financing and the option expired. Active, Ltd. lost its share of the funds invested in the option, the total of which was said by petitioner Stephen Greenwald to be in excess of \$100,000.00.

(c) The 50 shares of the common stock of Smith-Greenwald Properties, Inc. The 50 shares represented 50% of the outstanding stock. The corporation acquired an original screenplay entitled "The Grind" for \$175,000.00. One-half interest in the project was later sold to Dino DeLaurentiis Corporation. At the time of the hearing, Mr. Greenwald and his colleagues were still trying to get the film produced.

(d) The 6.25% interest in West End Developers Associates. West End Developers Associates is a New York general partnership which acquired a rental apartment building at 590 West End Avenue in New York City consisting of approximately 110 units and

converted it to a cooperative. While most apartments have been sold, West End Developers Associates still owned about 30 units at the time of the hearing.

The partnership agreement was amended for the second time as of December 6, 1983, when Beryl Lewis was admitted as a general partner. It was stipulated, however, that Lewis was to have no interest in the profits and losses of any investment previously made by the partnership, nor was she to be deemed to have made any capital investments with respect to same. Specifically, Lewis was not to be deemed as having an interest in the investments listed in Schedule A to the amendment of May 23, 1983 (Finding of Fact "19").

The amendment of December 6, 1983 also recited that effective that date, the partnership had acquired, by assignment, an undivided 35% interest as tenant-in-common in a completed motion picture entitled "Angel". The investments and separate interests of profits and losses of the partners relating to the film were as follows:

Greenwald: 90%  
Wenegrat: 5%  
Lewis: 5%

The investment was encumbered by a promissory note executed by petitioner Stephen Greenwald and payable to Angel Venture, a general partnership, and certain financing provided by Crocker Bank. The partners were liable for the note and financing to the extent of their percentages set forth above. Wenegrat and Lewis also agreed to indemnify and hold petitioner Stephen Greenwald harmless to the extent he was required to repay an amount in excess of 90% of the principal and interest arising under the note and/or financing.

Assignments by petitioner Stephen Greenwald to Active, Ltd., were made as follows:

(a) Mr. Greenwald assigned his option to purchase the screenplay "Aura" to Active, Ltd. on May 31, 1983.

(b) Mr. Greenwald assigned his 50% stock interest in Smith-Greenwald Properties, Inc. to Active, Ltd. on June 6, 1983.

(c) Mr. Greenwald assigned his undivided 35% interest in "Angel" to Active, Ltd. on December 6, 1983.

Active, Ltd. filed a Federal partnership return for 1983 showing the following income and deductions:

|  |                |
|--|----------------|
| Income:                                    |                |
| Ordinary income (loss)                     | \$(138,849.00) |
| Other income (loss)                        | 1,215.00       |
| Total income (loss)                        | \$(137,634.00) |
| Deductions:                                |                |
| Interest                                   | \$( 21,000.00) |
| Depreciation (from Form 4562) <sup>4</sup> | (363,300.00)   |
| Other deductions - advertising             | (350,000.00)   |
| Total deductions                           | \$(734,300.00) |
| Ordinary income (loss)                     | \$(871,934.00) |

Active, Ltd. issued a Schedule K-1 (Partner's Share of Income, Credits, Deductions, Etc.) to petitioner Stephen Greenwald showing a distributive share of ordinary loss of \$764,747.00 for 1983.

#### CONCLUSIONS OF LAW

A. In computing net income, an individual partner is allowed his distributive share of a partnership net operating loss (Internal Revenue Code § 702[a][8]). The net operating loss consists of excess deductions over the gross income of the partnership (Treas Reg § 1.703-1[a][1][ii]<sup>5</sup>). "Losses deductible by a partnership, and, therefore, distributable among the partners, must be connected with the partnership's business. The loss must be sustained in trade or business or for the production of income." (Mertens, Law of Federal Income Taxation § 35.157.)

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Form 4562 is not attached to petitioners' Exhibit "1".

<sup>5</sup>This regulation refers to Internal Revenue Code § 702(a)(9) which was redesignated § 702(a)(8).

B. In order for petitioners to substantiate the \$651,287.00 net partnership loss for 1983 with respect to Active, Ltd., they must show the ordinary and necessary business expenses deductible under Internal Revenue Code § 162(a) and also that the losses exceeded receipts by said amount.

C. Petitioners have failed to sustain their burden of proof under Tax Law § 689(e) and Administrative Code of the City of New York former § T46-189.0(e). While petitioners have established that petitioner Stephen Greenwald and Active, Ltd. were involved in the motion picture business, as well as other ventures, the amount of loss cannot be supported by the record.

Petitioners produced copies of Active, Ltd.'s partnership return and the Schedule K-1 issued to petitioner Stephen Greenwald, however, statements in a Federal income tax return are not sufficient, in and of themselves, to prove the truth of the assertions (Walker v Commissioner, 31 TCM 1037). In fact, the copy of the partnership return offered by petitioners consists

of only three pages and does not offer any details as to the deductions. It is noted, for example, that \$363,300.00 was claimed in depreciation, however, the requisite Form 4562 is not attached to the copy in the record.

Mr. Greenwald was the controlling person behind Active, Ltd. and satisfactory evidence of the deductions was within his possession and control. Such evidence was not produced (see, Walker v Commissioner, supra).

D. The petition of Stephen and Rebecca Greenwald is denied. The denial of their request for refund for 1982 and the Notice of Deficiency for 1983, as reduced pursuant to the Bureau of Conciliation and Mediation Services Conciliation Order, are sustained.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE